Financial regulation: 2001 Q3

1. INTRODUCTION

During the third quarter of 2001, several financial regulations of great significance for the development of financial markets were issued. First, the Ministry of Economy regulated the frontloading of euro banknotes and coins, setting the starting date for frontloading credit institutions and specifying the agents to which these institutions may frontload limited amounts of euro banknotes and coins before 1 January 2002.

Second, the European Central Bank (ECB) implemented a Recommendation setting forth the information that national central banks (NCBs) shall make available to the ECB in the field of balance of payments statistics, the international reserves template and international investment position statistics.

The Banco de España published a circular on the reporting of data on transactions and stocks of external assets and liabilities in marketable securities, setting up a new procedure for the collection of the information necessary to calculate portfolio investment and associated income, thus fulfilling the requirements laid down in Community legislation.

In the area of securities markets, it should be pointed out that the most significant provision issued during the first quarter of 2001 was the regulation implementing investor-compensation schemes, applicable both to investment services firms and credit institutions, which provide cover to investors where these institutions are unable to repay money or return securities or financial instruments owed to or belonging to the investor in connection with investment business.

In this line, a regulation implementing the legal regime of investment services firms has also defined the administrative regime to which these firms shall be subject with regard to such aspects as conditions for taking up business and operating conditions.

Finally, the conditions imposed on government-debt market makers to ensure the liquidity of the secondary market have been made more flexible by the Directorate General of the Treasury and Financial Policy.

2. FRONTLOADING OF BANKNOTES AND COINS AND OTHER PROVISIONS REGULATING CHANGEOVER TO THE EURO

Law 14/2000 of 29 December 2000 on fiscal, administrative and social measures (1)

(1) See “Financial regulation: 2000 Q4 ”, in *Economic bulletin,* Banco de España, January 2001, pp. 79-80.

amended Law 46/1998 of 17 December 1998 on the introduction of the euro (2), bringing forward from 30 June 2002 to 28 February 2002 the date on which banknotes and coins denominated in pesetas will lose their status of legal tender and will only retain their exchange value according to the conversion rate and the rounding rules defined in Law 46/1998. The Law also empowered the Ministry of Economy to regulate the distribution of limited amounts of euro banknotes and coins before 1 January 2002 in order to contribute to the smooth changeover to the euro.

Accordingly, *Ministerial Order of 20 July 2001* on the frontloading of euro banknotes and coins was published in the Official Gazette (BOE of 21 July 2001), setting the starting date for frontloading to credit institutions and specifying the agents to which these institutions may frontload limited amounts of euro banknotes and coins before 1 January 2002.

The delivery of coins, by the Treasury through the Banco de España, and of banknotes, by the latter to credit institutions located in Spain, started on *1 September 2001* and is being implemented in accordance with the frontloading arrangements concluded by the Banco de España and credit institutions. The Ministerial Order empowered the Banco de España to define the general frontloading conditions, which were laid down in *Resolution of 23 July 2001* (BOE of 25 July 2001). The most salient features of these regulations are discussed below.

Between 1 September 2001 and 1 January 2002, the Banco de España shall deliver euro banknotes to credit institutions located in Spain that are eligible for monetary policy operations and have concluded the relevant frontloading arrangement (hereinafter, the recipient credit institutions). These institutions shall keep the frontloaded banknotes in safe custody and shall not put them into circulation before 1 January 2002. Until that date, the Banco de España shall retain full title to the banknotes.

From the moment of frontloading until 1 January 2002, recipient credit institutions shall store the frontloaded banknotes safely in order to avoid damage, loss, theft, robbery, deterioration or any type of impairment whatsoever and they shall cover such risks by subscribing to appropriate insurance policies. Furthermore, recipient credit institutions shall be required not to put the banknotes into circulation, distribute them on a large scale and commence cash changeover before 1 January 2002.

As from 1 January 2002, the banknotes shall become the property of the recipient credit institutions, which shall settle the payment for their face value to the Banco de España. For this purpose, recipient credit institutions shall provide the Banco de España with adequate collateral by the close of business on 31 December 2001.

The same procedure, including provision of collateral, shall apply to euro coins, except that full title shall be retained by the Treasury, acting through the Banco de España, until 1 January 2002

With regard to the frontloading of euro banknotes outside Spain, recipient credit institutions shall be entitled to:

a) Distribute frontloaded banknotes from 1 September 2001 to their branches established inside the euro area.

b) Distribute frontloaded banknotes from 1 December 2001 to their branches or headquarters located outside the euro area, which shall not further distribute frontloaded banknotes to third parties before 1 January 2002.

c) Distribute frontloaded banknotes from 1 December 2001 to other credit institutions located outside the euro area, which shall not further distribute frontloaded banknotes to third parties before 1 January 2002.

As for the frontloading of euro coins outside Spain, recipient credit institutions shall be entitled to distribute them as from 1 September 2001 to their branches and headquarters or to other credit institutions located outside the euro area.

Similarly, in order to ensure a smooth changeover, under the aforesaid Ministerial Order, recipient credit institutions shall be entitled to distribute euro banknotes and, where appropriate, euro coins according to the following schedule:

1) Sub-frontloading of banknotes and coins from *1 September 2001* to major retailers, i.e. retailers with a large volume of sales, a number of business premises allowing a large flow of customers and a network covering most of the country. Contractual arrangements may also envisage sub-frontloading from that date to major currency operators, which are directly supplied with currency by cash-in-transit companies.

(2) Law 46/1998 of 17 December 1998. See "Financial regulation: fourth quarter 1998", in *Economic bulletin,* Banco de España, January 1999, pp. 83-90.

2) Distribution of limited amounts of euro banknotes and coins from *1 December 2001* to retailers (3), under the conditions laid down in the relevant frontloading arrangements.

3) Whenever agreed, the Treasury through the Banco de España and recipient credit institutions may offer small amounts of euro coins to the public from *15 December 2001* against their face value in pesetas.

Finally, the Ministerial Order empowers the Treasury to authorise the sub-frontloading of euro banknotes and coins to third parties other than major retailers and other currency operators, where appropriate.

In addition, *Ministerial Order of 16 July 2001* (BOE of 19 July 2001) provides for payments to be made in euro by central government, autonomous agencies and other public bodies from *15 September 2001*. Likewise, from the same date, the bank accounts of public bodies through which payments are made in euro, that have not yet been redenominated, shall be redenominated in euro.

3. STATISTICAL REQUIREMENTS OF THE EUROPEAN CENTRAL BANK

The Statute of the European System of Central Banks (ESCB) and of the ECB requires the ECB, assisted by the NCBs, to collect either from the competent national authorities or directly from economic agents the statistical information necessary in order for it to undertake the tasks of the ESCB.

For the fulfilment of its tasks, the ESCB needs to compile comprehensive and reliable monthly, quarterly and annual balance of payment statistics, monthly statistics showing the outstanding amount of reserve assets and annual international investment position statistics showing the main items affecting monetary conditions and exchange markets in the participating Member States, when the latter are seen as one economic territory.

The *Recommendation of the European Central Bank of 11 May 2000* on the statistical reporting requirements of the European Central Bank in the field of balance of payments statistics, the international reserves template and international investment position statistics (OJ of 21 June 2001) was issued for this purpose.

In accordance with the aforementioned Recommendation, the NCBs shall make available to the European Central Bank data on the cross-border transactions, stock of reserve assets, other foreign currency assets and reserve-related liabilities and cross-border positions necessary to enable the ECB to compile the aggregated balance of payments, international reserves template (4) and international investment position of the economic territory of the participating Member States, within the deadlines established in the annexes to the Recommendation.

4. REPORTING OF DATA ON TRANSACTIONS AND STOCKS OF EXTERNAL ASSETS AND LIABILITIES IN MARKETABLE SECURITIES

In line with the objectives discussed in the previous section, the ECB issued Guideline ECB/2000/4 of 11 May 2000, setting forth the information that NCBs were required to make available to the ECB in the field of balance of payments, international investment position and international reserves statistics, specifically with regard to portfolio investment and associated income. The portfolio investment and associated income data that were reported by the Banco de España to the ECB were based on the system of information on external receipts and payments laid down in CBE (Banco de España Circular) 15/1992 of 22 July 1992 (5), CBE 24/1992 of 18 December 1992 (6), CBE 1/1994 of 25 February 1994 (7) and CBE 6/2000 of 31 October 2000 (8), which did not allow all the Guideline requirements to be satisfied.

In order to meet these requirements, a new procedure for the collection of the information necessary to calculate portfolio investment and associated income has been set up in *CBE 2/2001 of 18 July 2001* (BOE of 2 August 2001) on the reporting of data on transactions and stocks of external assets and liabilities in marketable securities.

(3) Retailers are those businesses which are engaged in profit-making professional activities in which any type of items are offered for sale or services are provided to final users, whether through an establishment or not.

(4) The international reserves template means the statistical statement that reports with the appropriate breakdown stocks of reserve assets, other foreign currency assets and reserve-related liabilities of the Eurosystem at a reference date.

(5) See "Regulación financiera: segundo trimestre de 1992", in *Boletín Económico,* Banco de España, July-August 1992, pp. 90-91.

(6) See "Regulación financiera: cuarto trimestre de 1992", in *Boletín Económico,* Banco de España, January 1993, p. 74.

(7) See "Regulación financiera: primer trimestre de 1994", in *Boletín Económico,* Banco de España, April 1994, pp. 94-95.

(8) See "Financial regulation: 2000 Q4", in *Economic bulletin,* Banco de España, January 2001, pp. 75-76.

First, the scope of application of this Circular encompasses the following institutions (hereinafter, the subject institutions):

1) Resident banks, savings banks and credit co-operative banks.

2) Those other resident credit and financial institutions recorded in the official Banco de España or CNMV registries that act as deposit money institutions or settlement institutions in organised markets for marketable securities; those that hold assets in the form of marketable securities deposited with non-resident institutions, although they do not act as deposit money institutions or settlement institutions; and the management companies of mutual funds, in relation to the shares of non-residents in Spanish mutual funds.

3) Such other resident natural or legal persons as hold assets in the form of marketable securities with non-resident institutions.

The *institutions specified in paragraphs 1) and 2)* above shall send (by telematic means) to the Balance of Payments Office of the Banco de España, *with monthly periodicity,* the following information:

1) Information on marketable securities issued by non-residents, which shall include broad breakdowns of the transactions carried out and the stocks held by resident clients.

2) Information on marketable securities issued by residents, which shall include broad details of the transactions performed and stocks held by non-resident investors.

If they fulfil the following requirements these institutions can send this information with *quarterly periodicity* (instead of monthly):

a) That the total stocks of marketable securities held on own account or on the account of their clients as of 31 December of the previous year did not exceed EUR 60 million (about ESP 10 billion).

b) That their total transactions in marketable securities for own account or for the account of their clients during the previous year did not exceed EUR 600 million (about ESP 100 billion).

The resident legal and natural persons, specified in paragraph 3), who hold assets in the form of marketable securities with non-resident institutions, shall send to the Balance of Payments Office of the Banco de España, *with monthly periodicity,* less information than required from the above institutions. Specifically, it shall include:

1) Information on marketable securities issued by non-residents, including the transactions performed and stocks held by resident investors, with less detail than in the case of credit institutions.

2) Information on marketable securities issued by residents, including transactions performed and stocks of securities held by non-resident investors, with less detail than in the case of credit institutions.

However, they shall *not* be obliged to send the aforesaid information when the following requirements are fulfilled:

a) That their total stocks of marketable securities deposited with non-resident institutions as at 31 December of the previous year did not exceed EUR 6 million (about ESP 1 billion).

b) That their total transactions in marketable securities, carried out through non-resident institutions during the previous year, did not exceed EUR 60 million (about ESP 10 billion).

The Circular also provides that the subject institutions may send the information required jointly with another reporting entity *(presenting entity).* Entities that opt for this procedure (represented entities) shall supply to their presenting entities the information on their transactions and stocks, and those of their clients, with the necessary detail to meet the requirements of this Circular.

Also, the information on the transactions that Spanish mutual funds perform with marketable securities issued by non-residents, and on the related stocks, shall be supplied by the custodian institutions of the funds. Likewise, information on transactions that non-residents perform with shares in Spanish mutual funds and on the related stocks, shall be supplied by the management companies of the funds. However, this information may be provided by the related custodian institutions if that is what has been agreed between the latter and the management companies. Finally, the information on residents' transactions and stocks relating to shares in foreign mutual funds shall be provided by the resident institutions marketing this type of fund in Spain.

Finally, this Circular shall come into force on 1 January 2002. The first information that must

be notified shall relate to stocks of marketable securities as at 31 December 2001, and the transactions and stocks in January 2002. It must be sent during the first ten business days of February 2002.

5. INVESTOR-COMPENSATION SCHEMES

Directive 94/19/EC of 30 May 1994 (9) on deposit-guarantee schemes addressed the protection of the customers of credit institutions, setting up a harmonised minimum level of protection for the aggregate deposits of each customer, irrespective of the country of the EU in which they were located. This Directive was partially transposed into Spanish law by Royal Legislative Decree 12/1995 of 28 December 1995 (10) on urgent budgetary, tax and financial measures, and Royal Decree 2606/1996 of 20 December (11) on the deposit guarantee funds of credit institutions.

Directive 97/9/EC of the European Parliament and of the Council of 3 March 1997 (OJ L, 26.3.97) aimed to provide, in a similar way as for the customers of credit institutions, adequate protection to the clients of investment services firms (ISFs) (12) in the EU, by achieving the necessary and sufficient harmonisation to ensure a minimum level of protection for small investors in the event of ISFs being unable to meet their obligations to their clients. This directive was incorporated into Spanish law by Law 37/1998 of 16 November 1998 (13) on reform of the securities market, which set up the Investment Guarantee Fund (IGF). This law also introduced the relevant modifications to enable the Deposit Guarantee Fund (DGF) of credit institutions to protect their customers in relation to investment services.

Royal Decree 948/2001 of 3 August 2001 (BOE of 4 August 2001) now aims to implement the investor-compensation schemes, both for ISFs and for credit institutions through regulations. The object of these compensation schemes will be to offer investors cover when, owing to insolvency, an ISF or credit institutions is unable to repay amounts of money or return securities or financial instruments held on their behalf. In no case will this scheme cover credit risk or losses arising from the fall in value of an investment on the market.

Accordingly, two investor-compensation schemes have been set up:

1) One operating through one or two newly created Investment Guarantee Funds (IGFs) for ISFs (with the exception of portfolio management companies), as well as for the branches in Spain of foreign investment services firms.

2) The other operating through existing Deposit Guarantee Funds (DGFs) for credit institutions.

5.1. Investment guarantee funds

IGFs shall be set up as legally dependent autonomous portfolios of assets. Their representation and management shall be entrusted to a management company.

The *member entities of IGFs* shall be national ISFs, excluding portfolio management companies (national securities-dealer companies and securities agencies), which have their own special arrangements (discussed below). As regards the branches of foreign ISFs, which do not limit their activity to managing portfolios on a discriminatory, client-by-client basis, a distinction is drawn between those whose home country is inside the EU and those whose home country is outside the EU. In the case of branches whose head office is in an EU country, membership shall be voluntary when the cover afforded in their home country is less, in order to top up such cover. However, in the case of branches of non-EU investment firms, whether membership is compulsory or not will depend on whether there exists any cover in the home country, and if there does, its level. Those branches that are either unable to evidence membership of a similar fund in their home country or whose home country guarantee fund is unable to provide the same cover as that afforded by funds regulated by this Royal Decree shall be obliged to join a fund.

Securities-dealer companies and securities agencies belonging to a stock exchange, when a sufficient number of them agree to join, may set up a second IGF for themselves. In that case, each of them may opt for either of the two funds. The comments made here in relation to

(9) See "Regulación financiera: segundo trimestre de 1994", in *Boletín Económico,* Banco de España, July-August 1994, pp. 97-98.

(10) See "Regulación financiera: cuarto trimestre de 1995", in *Boletín Económico,* Banco de España, January 1996, pages 78-80.

(11) See "Regulación financiera: cuarto trimestre de 1996", in *Boletín Económico,* Banco de España, January 1997, pages 106-109.

(12) According to article 64 of Securities Market Law 24/1988 of 28 July 1998, as amended by Law 37/1998 of 16 November 1998, investment services firms include securities-dealer companies, securities agencies and portfolio management companies.

(13) See "Financial regulation: fourth quarter 1998", in *Economic bulletin,* Banco de España, January 1999, pp. 90-96.

the IGF shall be understood to apply to both of these funds.

The *coverage of the IGF* extends to the money and securities that customers have entrusted to the firms to carry out investment services, but not to losses arising from the fall in value of investments or to any credit risk. The protected securities shall include those subject to repurchase agreements to which title remains with the vendor. The IGF shall ensure that every investor receives the money value of their overall credit position with the firm, subject to an *upper limit of EUR 20,000.* The investor's position shall be determined by considering all the accounts open in the investor's name with the investment services firm, taking into account the sign of their balances, whatever the currency of denomination. The amount of money funds and the market value of financial assets shall be used to calculate the credit position. Where such assets are not traded on any Spanish or foreign secondary market valuation criteria shall be established.

Two kinds of exception to this cover are established, one based on the location of the investment services firm and the other on the type of investor. As regards the former, branches of Spanish investment firms located in territories defined as tax havens, or in countries that either lack a securities market supervisory agency or refuse to exchange information with the CNMV, are excluded from IGF cover. Securities and financial instruments entrusted to the branches of Spanish credit institutions located in non-EU countries that lack national investor-compensation schemes equivalent to the Spanish ones shall not be covered either. As regards the second exception, the IGF shall only protect non-professional investors and, therefore, will not cover money or securities belonging to investors considered to be professionally qualified, such as all types of financial institution. Neither will the IGF cover the assets entrusted by general government or natural persons that, either have representative positions in the investment services firms, or else are considered to have acted in bad faith.

As regards the *declaration of default,* investors who are unable to obtain directly from an entity belonging to the fund repayment of money or return of assets belonging to them may apply to the management company of the IGF for enforcement of the guarantee afforded by the fund, provided that the investment services firm has been declared insolvent, whether judicially, in the event of suspension of payments or insolvency, or administratively, by the CNMV.

As for their *financial regime,* IGFs shall be financed primarily through the annual contributions of their member entities, which shall be equal to 0.2% of the money, plus 0.01% of the value of the financial assets deposited by investors. The management company shall distribute this overall annual contribution among the firms belonging to the fund, according to the number of customers and the amount of the money or assets covered by the guarantee. It may also arrange loans and credit with financial institutions, in order to meet its obligations to investors under this Royal Decree.

At the time of their establishment in Spain, branches of ISFs shall notify the CNMV of whether they are required to join a fund according to the provisions of this Royal Decree. If they are, they shall be obliged to contribute to the IGF the amount established as the minimum initial contribution in the relevant annual budget approved by the CNMV.

When the net assets of the IGF have reached a sufficient level for it to fulfil its purposes, the Ministry of Economy, at the proposal of the CNMV, may approve a reduction in the aforesaid contributions. Conversely, when the management company of an IGF foresees that the net assets and financing available to the fund during a year are insufficient, it shall require the members to make extraordinary contributions of an amount necessary to cover the financial or net asset shortfall.

Investment services firms that fail duly to pay their ordinary or special contributions to the IGF or fail to meet their obligations under this Royal Decree may be excluded from the fund if they do not regularise their situation within the required period. The CNMV is authorised to resolve their exclusion, after a report of the management company of the IGF and having given a hearing to the entity concerned. Also, exclusion shall be grounds for the Ministry of Economy, upon a proposal of the CNMV, to revoke the authorisation that it may have granted the entity to carry on business, when the excluded entity has its head office in Spain.

As for the *period within which investors shall be paid their compensation, the IGF shall pay the compensation to investor*s, whose entitlement has been duly verified, in cash within three months of the declaration of default provided for in this Royal Decree. The CNMV is authorised to extend this period by a further three months when it deems that there are exceptional circumstances to justify such a delay.

Finally, although this Royal Decree provides that it shall enter into force on the day following

its publication, it is stipulated that the cover of the IGF will extend back to 1 July 1993, the date of effectiveness of Directive 93/22/EEC of 10 May 1993 on investment services in the securities field.

5.2. The management companies of Investment Guarantee Funds

The *management companies* shall have the legal status of public limited companies, with a share capital sufficient to ensure they can achieve their corporate objects, subscribed for by the members of each IGF in accordance with the same criteria as govern their contributions. Such share capital may be changed in order to adjust the shares of each of the member entities as a consequence of new members joining or existing members leaving the fund, or of changes in the percentage shares of the corporations already belonging to the fund.

The CNMV shall be responsible for supervising these management companies.

The appointment of directors and the general manager shall comply with the requirements laid down in the Securities Market Law and shall require the prior approval of the CNMV. There shall be a representative of the CNMV on the board of directors with the right to speak but not vote, who shall ensure that rules regulating the activity of the fund are complied with.

The management company shall have the following duties:

a) To represent and manage the IGF, and to administer its assets.

b) To pay compensation out of the IGF and to exercise on behalf thereof the rights to which it has been subrogated.

c) To notify the CNMV and take such measures as may be necessary in the event of default by member investment services firms on any of their obligations, both to the fund and the management company. Should it be necessary, to propose to the CNMV both suspension of a member entity and revocation of the authorisation granted to it to carry on its activity.

d) To provide the CNMV with such assistance as it may request in the exercise of its supervision, inspection and sanctioning functions.

e) To charge the IGF, as a management fee, the expenses incurred as a consequence of its representation and management that are not directly recoverable therefrom.

f) To inform investors of the scope and content of the fund.

5.3. Deposit guarantee funds of credit institutions and the cover of the investment guarantee scheme

This Royal Decree also aims to develop the legal system relating to the cover that credit institutions must provide for investment services. This involves certain amendments to Royal Decree 2606/1996 of 20 December 1996 (14) on deposit guarantee funds, with the same content as in the case of the IGFs just discussed, but respecting the differences arising from the specific structure of each type of fund and its specific regulation (see Table 1).

One of the main changes made by this new regulation relates to the *extent of the guarantee* assumed by credit institutions; as from the publication of the aforementioned Royal Decree, the DGF not only covers *guaranteed deposits* (as envisaged under the previous regulation), but also *guaranteed securities.*

Specifically, as regards guaranteed deposits, the Royal Decree covers those envisaged in RD 2606/1996, i.e. credit balances on accounts, funds arising from temporary situations in business transactions and registered certificates of deposit that the institution is obliged to return under the applicable legal and contractual conditions (provided that they are created in Spain or another EU Member State), and also extends to the money that the customer has entrusted to the institution to carry out some investment service or that arises from the provision of such services or activities.

As for guaranteed securities, the Royal Decree covers the marketable securities and financial instruments stipulated in the Securities Market Law that customers have entrusted to a credit institution in Spain or in any other country, for deposit or registration or for the performance of some investment service. Securities subject to repurchase agreements that remain entered or registered in the name of the vendor shall be included among the guaranteed securities.

However, as commented above for the IGF, the DGF shall not protect securities or fi-

(14) See "Regulación financiera: cuarto trimestre de 1996", in *Boletín Económico,* Banco de España, January 1997, pp. 106- 109.

TABLE 1

Comparison between the Investment Guarantee Fund and the Deposit Guarantee Fund

INVESTMENT GUARANTEE FUND	DEPOSIT GUARANTEE FUND
LEGAL PERSONALITY	
Legally dependent, autonomous portfolio of assets, whose management and representation is entrusted to a management company.	Separate legal entity, with full capacity to pursue its objects under private law and not subject to the rules regulating public bodies.
SUPERVISORY BODY	
Comisión Nacional del Mercado de Valores (CNMV).	Banco de España (BE).
MEMBER ENTITIES	
1. Securities-dealer companies and securities agencies 2. Branches of foreign investment services firms, depending on the system of cover in their home country.	1. Banks, savings banks and credit co-operative banks 2. Branches of foreign credit institutions, depending on the system of cover in their home countries.
COVER OF THE FUND	
Money and securities that customers have entrusted to the firms to carry out investment services.	Guaranteed deposits and securities.
FUND ASSETS	
Annual contributions of the member entities, and special contributions in exceptional circumstances.	Annual contributions of member institutions, and special contributions in extraordinary circumstances and, exceptionally, contributions by the Banco de España.
AMOUNT GUARANTEED	
Money value of the overall credit position in the investment services firm subject to an upper limit of EUR 20,000.	Guaranteed deposits shall be limited to EUR 20,000. Guaranteed securities shall have a limit independent of that corresponding to deposits, which shall be no more than EUR 20,000.
GROUNDS FOR EXECUTION OF THE GUARANTEE	
That the investment services firm has been declared insolvent, either judicially, in the event of suspension of payments or insolvency, or else administratively, by the CNMV.	That the credit institution has been declared insolvent, either judicially, in cases of suspension of payments or insolvency, or else administratively, by the BE.

nancial instruments entrusted to a credit institution to carry out investment services and supplementary business in territories defined by current law as tax havens, or in countries that either lack a securities market supervisory agency or refuse to exchange information with the CNMV. Neither will the DGF protect securities and financial instruments entrusted to branches of Spanish credit institutions located in non-EU countries that have national investor-compensation schemes equivalent to the Spanish ones, since in that case the cover is afforded by the country in which the institution is located. Under no circumstances shall the cover extend to securities entrusted by institutional investors, or securities belonging to persons that have representative positions in the institution that gives rise to action by the DGF or persons who have violated current provisions or have contributed to the deterioration of the institution's financial situation.

Another change made in this new regulation relates to the *assets of the funds.* Specifically, the institutions belonging to the DGFs are obliged to comply with the financial regime of annual contributions and special contributions laid down by this Royal Decree, so that they can meet their obligations to depositors and investors under this Decree. As regards special contributions, which did not exist under the previous regulation, the management company may require them to be paid by the member institutions when the net assets of the funds are negative. The total amount of such contributions cannot exceed the value of the shortfall, and it shall be distributed among the institutions in the same proportions as the annual contributions.

As regards the *amounts guaranteed,* the deposits shall be guaranteed for up to EUR 20,000. The amount guaranteed to investors that have entrusted securities or financial instruments to a credit institution shall be independent of that corresponding to deposits and shall be subject to a maximum of EUR 20,000. The guaranteed amounts shall be paid in cash.

5.4. Rules applicable to portfolio management companies

As mentioned above, portfolio management companies do not belong to IGFs, so that they must insure the risks arising from their activities by means of liability insurance taken out with an insurance company legally authorised to operate in the field of civil liability in the EU. The insured sum shall be not less than EUR 1,225,000 (about ESP 204 million). The benefits of such insurance shall be used exclusively to pay the damages caused to their clients arising from the performance of investment services specific to their business. This requirement shall be complied with within six months of this Royal Decree coming into force (by 5 February 2002), and the CNMV shall be notified of compliance, which shall be recorded in the public register of ISFs.

6. LEGAL REGIME FOR INVESTMENT SERVICES FIRMS

6.1. Background

Comprehensive reform of the Spanish securities markets was undertaken by Law 24/1988 of 28 July 1988 (15). One of the main objectives of the Law was to strengthen these markets in the lead up to a single EU securities market in 1992.

The construction of a single European financial market has in recent years been based on three important directives:

First, Directive 89/646/EEC of 15 December 1989 (16) (the Second Banking Directive) was essential to achieve a common framework for the activities of credit institutions within the EU, from the point of view both of the right of establishment and of the freedom to provide services. The Directive was transposed into Spanish law by means of Law 3/1994 of 14 April 1994 (17), which basically widened and modified the contents of Law 26/1988 of 29 July 1988 (18) on the discipline and administration of credit institutions, in order to include the provisions of this Directive.

Second, Directive 93/6/EEC of 15 March 1993 (19) on the capital adequacy of investment firms and credit institutions was published, with the aim of harmonising the elements considered essential to secure the mutual recognition of authorisation and of prudential supervision systems of investment firms.

(15) See “Financial regulation: fourth quarter 1998”, in *Economic bulletin,* Banco de España, January 1999, pp. 90-98.

(16) See “Regulación financiera: primer trimestre de 1990”, in *Boletín económico,* Banco de España, April 1990, pp. 71-72.

(17) See “Regulación financiera: segundo trimestre de 1994”, in *Boletín económico,* Banco de España, July-August 1994, pp. 92-96.

(18) See “Regulación financiera: tercer trimestre de 1988”, en *Boletín económico,* Banco de España, October 1988, pp. 56-58.

(19) See “Regulación financiera: segundo trimestre de 1993 ”, in *Boletín económico,* Banco de España, July-August 1993, pp. 108-109.

Finally, Directive 93/22/EEC of 10 May 1993 (20) on investment services in the securities field was essential to the achievement of the internal market, from the point of view both of the right of establishment and of the freedom to provide services, in the field of investment firms. The investment services Directive, like the Second Banking Directive, introduced the principle of the Community passport or single licence (21), which is based on the harmonisation of the conditions for authorisation and pursuit of the activity, as well as of the prudential supervision systems (22) for investment firms.

This Directive was transposed into Spanish law by means of Law 37/1998 of 16 November 1998, amending Law 24/1988 of 28 July 1988 on the Securities Market. Adaptation to this Directive meant that any investment services firm (ISF) (23), whether or not Spanish, which is authorised in one EU Member State, can *become a member of or have access to all EU markets*, including the Spanish market, and also become a member of or have access to clearing and settlement systems.

Law 37/1998 has recently been implemented by means of *Royal Decree 867/2001 of 20 July 2001* (BOE of 7 August 2001) on the legal regime of ISFs, regulating the administrative regime to which these firms shall be subject with regard to such aspects as conditions for taking up business and operating conditions. At the same time, the aforementioned Royal Decree repeals Royal Decree 276/1989 of 22 March 1989 on securities-dealer companies and securities agencies, as well as Title IV of Royal Decree 1393/1990 of 2 November 1990, which adopts the regulations governing portfolio management companies laid down in Law 46/1984 of 26 December 1984 regulating collective investment undertakings.

6.2. ISF business and operating conditions

ISFs may provide the following *investment services*: reception and transmission of orders on behalf of third parties; execution of such orders on behalf of third parties; dealing for own account; managing portfolios of investments in accordance with mandates given by investors on a discriminatory, client-by-client basis; mediation, directly or indirectly, on behalf of the issuer in the placement of new issues and public offers of securities; underwriting the subscription of new issues and public offers.

ISFs may also provide inter alia the following *non-core services*:

a) Safekeeping and administration of financial instruments, such as marketable securities, money market instruments, any type of contracts traded on a secondary market, financial futures contracts, financial options contracts, swaps and any contracts or transactions in instruments which may be traded on a secondary market, whether official or not.

b) Granting credits or loans to investors to allow them to carry out a transaction in one or more of the instruments listed in a) above.

c) Advice to undertakings on capital structure, industrial strategy and related matters and advice and service relating to mergers and the purchase of undertakings.

d) Services related to underwriting.

e) Acting as registered dealers to carry out foreign exchange transactions where these are connected with the provision of investment services.

ISFs may obtain funds from Spanish or foreign financial institutions recorded in the official registers of the Banco de España, the National Securities Market Commission (CNMV), the Directorate General of Insurance or in equivalent EU registers (hereinafter, the financial institutions). They may also carry out lending or borrowing activities with the aforesaid financial institutions, with the restrictions that may be imposed by the Ministry of Economy.

Likewise, ISFs may not obtain funds from persons other than financial institutions, except in the form of subordinated finance and from the issuance of shares or of securities admitted to listing on an official secondary market. Notwithstanding, securities-dealer companies and securities agencies shall be allowed to keep special temporary customer accounts for the execution of transactions carried out for the account of such customers. The balances of these accounts shall be

(20) See "Regulación financiera: segundo trimestre de 1993", in *Boletín Económico,* Banco de España, July-August 1993, pp. 106-108.

(21) This principle means that an investment services firm authorised in the EU Member State in which it has its registered office may establish branches and provide investment and non-core services in other Member States.

(22) Recognition of supervision systems enables the principle of supervision by the home Member State to be applied.

(23) Law 37/1998 defines investment services firms as financial institutions the main business of which is the provision of investment services for third parties on a professional basis. This category includes securities-dealer companies, securities agencies and portfolio management companies. These firms may carry on business in other EU Member States under the principle of the Community passport which gives them the right of establishment and the freedom to provide services.

invested in liquid low-risk assets, as determined by the Ministry of Economy.

6.3. Types of investment services firms

The following entities are considered to be investment services firms:

1) *Securities-dealer companies*, which may carry on business for own account and for third parties on a professional basis and provide all the above-mentioned investment and non-core services.

2) *Securities agencies,* which may carry on business solely for third parties on a professional basis and may provide investment and non-core services other than dealing for own account, underwriting the subscription of new issues and public offers and granting credits or loans to investors.

3) *Portfolio management companies*, which may manage portfolios of investments in accordance with mandates given by investors on a discriminatory client-by-client basis and provide non-core services related to advice.

Credit institutions, even though they are not ISFs, may normally provide all investment and non-core services, provided that their legal regime, their articles of association and their specific authorisation enable them to do so. Foreign credit institutions providing some investment services in Spain shall be governed by Royal Decree 1245/1995 of 14 July 1995 on the creation of banks, cross-border activities and other matters related to the legal regime of credit institutions. Likewise, the Banco de España shall supply information on foreign or Spanish credit institutions providing investment services in Spain to the CNMV, which shall record it in its registers.

6.4. Legal regime for ISFs

Creation of an ISF

The creation of an ISF or the conversion of a company into an ISF shall be subject to authorisation by the Ministry of Economy on a proposal by the CNMV. The authorisation shall be granted and shall not be withdrawn provided that the following requirements are fulfilled:

a) The sole corporate purpose of the firm shall be to carry on the activities of an ISF.

b) The ISF shall be a public limited company, except for portfolio management companies, which may be private limited companies.

c) The share capital and own funds of the ISF shall not be less than the following amounts:

— For securities-dealer companies: EUR 2 million (approximately PTA 333 million).

— For securities agencies: EUR 300,000 (around PTA 50 million), unless they intend to become members of secondary markets or of securities clearing and settlement systems, or they include securities borrowing in their programme of operations and may keep special temporary credit accounts, in which case their share capital shall not be less than EUR 500,000 (around PTA 83 million).

— For portfolio management companies: EUR 100,000 (around PTA 17 million).

d) The board of directors of the ISF shall be composed of at least five members (securities-dealer companies) or three members (securities agencies and portfolio management companies) meeting fitness and properness standards.

e) The ISF shall have a good administrative and accounting structure, adequate physical and human resources to implement its programme of operations and internal control and security procedures.

f) The ISF shall have internal rules of conduct.

g) Securities-dealer companies and securities agencies shall join an investment guarantee fund (see previous section) and portfolio management companies shall take out liability insurance with a legally authorised financial institution.

h) The ISF shall have its registered office and its headquarters within Spanish territory.

Liquidity ratio

ISFs other than portfolio management companies shall maintain, as a minimum, a 10% liquidity ratio of investments in highly liquid low-risk assets to total current liabilities with residual maturity of less than one year (excluding from the latter the balances of credit accounts arising from financial transactions with the public). The Ministry of Economy and the CNMV, specifically empowered by the Ministry, shall define the assets which are eligible for compliance with the liquidity

ratio, the accounting and valuation standards applicable to current liabilities balances and the procedures for the monitoring of compliance with the aforementioned ratio.

Table 2 shows the most significant new provisions introduced in the legal regime of ISFs:

6.5. Legal regime of qualifying holdings and capital reporting requirements

A qualifying holding in an ISF means any direct or indirect holding which represents 5% or more of the capital or of the voting rights of the ISF or any smaller holding which makes it possible to exercise a significant influence over the firm. Any legal or natural person who proposes to acquire (or dispose of) a qualifying holding in an ISF shall be required first to inform the CNMV. Such a person shall likewise inform the CNMV if he proposes to increase (or reduce) his qualifying holding so that the proportion of the voting rights or of the capital that he holds would reach 10%, 15%, 20%, 25%, 33%, 40%, 50%, 66% or 75%. The CNMV shall have up to two months to oppose such a plan.

TABLE 2

Changes in the legal regime and ratios for ISFs

Securities-dealer companies and securities agencies (RD 276/1989 of 22 March 1989)	*Securities-dealer companies and securities agencies (RD 867/2001 of 20 July 2001)*
Share capital Securities-dealer companies shall have a minimum share capital of ESP 750 million (EUR 4.51 million) and securities agencies ESP 150 million (EUR 0.9 million).	**Share capital** Securities-dealer companies shall have a minimum share capital of ESP 333 million (EUR 2 million) and securities agencies ESP 50 million (EUR 300,000) or ESP 83 million (EUR 500,000), as the case may be.
Composition of board of directors In the case of securities agencies that are members of a stock exchange, there is an additional requirement that each member of the board of directors shall hold not less than 5% of the share capital, and that all their shares are held by natural persons.	**Composition of board of directors** This additional requirement disappears.
Liquidity ratio They shall maintain a liquidity ratio of at least 10% (Ministerial Order of 28.07.89), as measured by the volume of investments in highly liquid low-risk assets as a percentage of total current liabilities with a residual maturity of less than one year (excluding from the latter the balances of credit accounts arising from financial transactions with the public).	**Liquidity ratio** They shall maintain a liquidity ratio of at least 10%, as measured by the volume of investments in highly liquid low-risk assets as a percentage of total current liabilities with a residual maturity of less than one year (excluding from the latter the balances of credit accounts arising from financial transactions with the public).
Portfolio management companies (RD 1393/1990)	*Portfolio management companies (RD 867/2001 of 20 July 2001)*
Share capital They shall have a minimum share capital of ESP 10 million (EUR 60,000) plus 5% of the first ESP 10 million of assets managed and 3% of any additional assets managed.	**Share capital** They shall have a minimum share capital of ESP 17 million (EUR 100,000).

6.6. ISF branches and agents

Spanish ISFs shall have the freedom to establish branches on the national territory but they shall be required first to inform the CNMV, which may request additional information on the physical and human resources available and on the adequacy of control systems.

Likewise, ISFs may grant a power of attorney to legal or natural persons (agents) for the promotion and marketing of the investment services included in their programme of operations. They may also grant a power of attorney to the aforementioned agents to provide habitually a number of investment and non-core services to customers, provided that these activities are included in the programme of operations of the ISF registered at the CNMV. Agents shall carry on business exclusively for a single ISF and shall in no case act on behalf of investors.

6.7. Cross-border activities of ISFs

Establishment of branches and provision of services in Spain by foreign ISFs

The establishment in Spain of *branches* of entities of non-EU Member States, which do not have the status of ISFs but nonetheless provide some investment services, shall be subject to *authorisation* by the Ministry of Economy, on a proposal by the CNMV, and shall fulfil the same requirements as those applied to the authorisation of an ISF in Spain, under certain conditions. The corporate purpose of the branch shall not include activities that it is not allowed to carry on in its home country.

The establishment in Spain of branches of ISFs authorised in another EU Member State shall not be subject to authorisation. However, the competent supervisory authorities shall first provide the CNMV with information on specific aspects, such as the programme of operations envisaged, the name of those responsible for the management of the branch and details of any investor-compensation scheme intended to protect investors.

ISFs authorised in another EU Member State may commence business in Spain for the first time *under the freedom to provide services*, on receipt by the CNMV of a communication from the competent supervisory authorities providing information on the activities envisaged. This regime shall be applicable whenever the ISF proposes for the first time to carry out in Spain activities other than those reported in the aforesaid communication. The CNMV shall indicate to the ISFs the conditions and rules of conduct with which the providers of investment services must comply in Spain.

Entities not authorised in another EU Member State which propose to provide investment services in Spain without a branch shall apply for *authorisation* to the CNMV, providing information on the activities they intend to carry on.

Establishment of branches and provision of services abroad by Spanish ISFs

Spanish ISFs wishing to establish a branch abroad shall apply for authorisation to the CNMV, specifying the State within the territory of which they plan to establish a branch and providing a programme of operations setting out the business envisaged and the names of those responsible for the management of the branch. Where the ISF branch is to be established in another EU Member State, the CNMV shall, where appropriate, forward the authorisation to the competent authorities of that Member State. Where the ISF branch is to be established in a non-EU Member State, the CNMV may reject the application inter alia on the grounds that the branch shall not be subject to effective control by the supervisory authorities of the host country or that there are legal or other obstacles preventing or hindering control and supervision of the branch by the CNMV.

The creation of a foreign ISF by a Spanish ISF or group of ISFs or the direct or indirect acquisition of a holding in an existing ISF, where the foreign ISF is to be created or has its registered office in a non-EU Member State, shall be subject to *authorisation* by the CNMV.

Finally, Spanish ISFs wishing to operate for the first time under the freedom to provide services in a non-EU Member State shall apply for authorisation to the CNMV, providing information on the authorised activities that they intend to carry on. The authorisation procedure shall be similar to that applied to the establishment of branches. Where services are to be provided in another Member State, ISFs shall only be required to first notify the CNMV, specifying the authorised activities that they intend to carry on. The CNMV shall forward this information to the competent authorities of the Member State concerned.

7. Changes in relation to government-debt market makers

A resolution of the Executive Council of the Banco de España of 19 January 1988, defined the term "market maker" and regulated the conditions for attaining and retaining such status,

as well as the relations between market makers and the Banco de España. These conditions have been revised with some regularity, the latest change being that made by the Ministerial Order of 10 February 1999, implemented by the Resolution of the Directorate General of the Treasury and Financial Policy (the Treasury) of 11 February 1999 (24), the purpose of which was to adapt the definition of "market maker" to the changes in the government debt markets themselves as a consequence of European integration and the introduction of a single monetary policy. Specifically, this Resolution established as one of the obligations of government-debt market makers, that of ensuring secondary market liquidity. This required them to quote certain benchmark bonds in accordance with the specific conditions set out in the Resolution. In the light of experience it is desirable to introduce greater flexibility in the setting of these conditions, taking into account market circumstances and State issuance policy.

Accordingly, the *Resolution of the Directorate General of the Treasury and Financial Policy of 31 July 2001* (BOE of 8 August 2001), provides that the Treasury may change the conditions of quotation laid down in the Ministerial Order of 10.2.99, subject to agreement with market makers.

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(24) See "Financial regulation: first quarter 1999", in *Economic bulletin,* Banco de España, April 1999, pp. 60-62.